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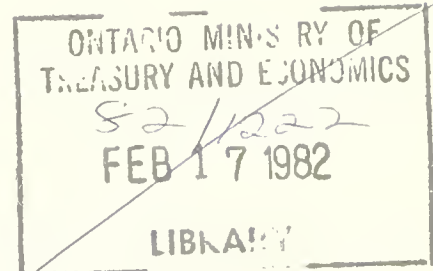
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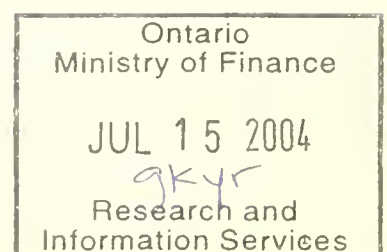
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THE AUTO INDUSTRY:
CURRENT CONDITIONS AND OUTLOOK

Office of Economic Policy
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THE AUTO INDUSTRY

SUMMARY

Current Performance and Outlook

Canadian auto and parts production has been falling since the first quarter of 1979. In 1979-to-date, combined production has plunged 12.1 per cent at a seasonally adjusted annual rate. October Ontario employment levels in motor vehicle and parts and accessories industries are 13.8 and 15.7 per cent below their year-earlier levels respectively.

- . The slump in U.S. auto sales and subsequent high U.S. auto inventory levels, combined with the mismatch of auto models produced in Canada with U.S. sales growth areas (i.e. subcompacts), have contributed to this decline.

The fall in U.S. auto sales cut into our exports. Canadian auto sales, meanwhile, have remained buoyant. Consequently, imports, most of which come from the United States, are higher.

- . In the first eleven months of 1979, the auto and parts deficit rose to \$2.9 billion as the vehicle surplus dwindled and the parts deficit widened. The eleven month deficit is three and a half times the 1978 annual deficit.

Canadian motor vehicle and parts production is expected to plunge in 1980 as auto manufacturers adjust their inventory positions, according to the Conference Board. Both Canadian and U.S. unit auto sales are expected to decline in 1980. The auto trade deficit will worsen in 1980 with most of the increase in the deficit accounted for by weaker parts trade.

Medium Term Issues

In order to meet the future needs of the auto market, the North American auto producers have embarked on an extensive investment program. Investment intentions indicate that \$750 million will be spent this year in Canada. The capital demands required to finance this investment come at a time when considerable cash flow strains are being experienced by the auto companies. Governments, both Canadian and American, have rushed to the auto companies aid, giving and lending money but with strings attached.

- . To date, the Employment Development Fund has provided \$32.5 million in grants and \$1.5 million in loan guarantees to Ford and fourteen auto parts firms. It is estimated that the grants and loans will, over the next five years, create 5,213 jobs, increase investment by \$629.1 million and raise direct exports by \$658.8 million.

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THE AUTO INDUSTRY

The Canadian auto industry consists of three distinct sectors: autos, trucks and parts and accessories. The determinants of demand in each sector are, for the most part, quite unique.

- . U.S. auto sales performance and inventory levels are major determinants of Canada's auto production since over 70 per cent of our output is exported to the U.S.
- . The demand for Canadian produced trucks is affected more by Canadian than U.S. sales performance since almost 60 per cent of Canadian made trucks are produced for the domestic market.
- . Approximately 75 per cent of Canadian auto parts and accessories production is exported to the U.S., most of which is sold in the original equipment market.

CURRENT PERFORMANCE

Production and Employment in Canada and Ontario

Reacting to the slump in U.S. auto sales, which began in 1979:2, Canadian auto industry activity plunged, as seen in Table 1. Canadian motor vehicle assembly production declined in the second and third quarters of 1979 at seasonally adjusted annual rates of 39.2 and 7.9 per cent respectively. During this same period, Canadian auto parts and accessories production fell 55.8 and 30.8 per cent respectively. The main reasons for the drop in Canadian auto production are:

- . the general slump in U.S. auto sales;
- . the mismatch of auto models produced in Canada with U.S. sales growth areas (i.e. subcompacts);
- . the strong but softening sales in Canada.

The weakness in the auto industry was even more evident in the most recent production and employment figures.

- Canadian auto assembly production has dropped dramatically in the last two months, plummeting at a seasonally adjusted monthly rate of 14.5 per cent in October and 3.1 per cent in November.
- Ontario employment in October in motor vehicle assembly was 13.8 per cent below year-earlier levels; parts and accessories' employment fell by 15.7 per cent.

AUTO SECTOR PERFORMANCE, ONTARIO AND CANADA, 1978-1979 November Table 1
(Per Cent Change)

	1978	1979:1	1979:2	1979:3	Aug.	Sept.	1979 Oct.	Nov.
<u>Canada</u>								
Production (1971 \$)*								
• Motor Vehicles*	1.0	6.6	-39.2	-8.2	-8.7	18.4	-14.5	-3.1
• Parts and Accessories*	5.5	2.0	-55.8	-34.5	-11.0	11.6	2.9	-21.3
<u>Employment</u>								
• Motor Vehicles	3.4	2.3	4.0	2.4	4.2	1.1	-9.6	n.a.
• Parts and Accessories	7.2	5.9	0.5	-7.9	-6.9	-14.4	-14.9	n.a.
<u>Ontario</u>								
<u>Employment</u>								
• Motor Vehicles	2.6	-0.3	0.9	-0.4	1.3	-1.4	-13.8	n.a.
• Parts and Accessories	7.0	5.4	-0.4	-8.7	-7.7	-15.5	-15.7	n.a.

* Seasonally adjusted data, for which change is from the preceding period -- at annual rates for the quarterly data and at monthly rates for the monthly data. For the other items in the table, change is from the year-earlier period.

Canadian unit motor vehicle production in 1979 was adversely affected by weak U.S. markets and the energy crunch. Unit auto production declined by 15.0 per cent in 1979 while truck production declined by 1.8 per cent as seen in Table 2.

- General Motor's implementation of an auto downsizing strategy enabled the company to weather the energy crunch better than either Ford or Chrysler.
- American Motors' gain of 17.6 per cent reflects the re-tooling of their Brampton plant from passenger vehicles to the very popular Jeeps.

CANADIAN MOTOR VEHICLE PRODUCTION, 1978-1979
(Units)

Table 2

	1979	1978	% Change
<u>Autos</u>			
American Motors	-	26,286	-
Chrysler	134,086	179,093	-25.1
Ford	286,416	377,172	-24.1
General Motors	558,405	571,683	-2.3
Volvo	8,766	8,199	6.9
Total	987,673	1,162,433	-15.0
<u>Trucks</u>			
American Motors	51,925	17,881	190.4
Chrysler	60,872	76,407	-20.3
Ford	214,423	252,313	-15.0
General Motors	288,788	283,142	2.0
International	20,153	19,325	4.3
Mack	3,849	3,534	8.9
White	3,978	3,457	15.1
Total	643,988	656,059	-1.8
<u>All Vehicles</u>			
American Motors	51,925	44,167	17.6
Chrysler	194,958	255,500	-23.7
Ford	500,839	629,485	-20.4
General Motors	847,193	854,825	-0.9
Others	36,746	34,515	6.5
Total	1,631,661	1,818,492	-10.3

The employment data does not fully reflect the magnitude of the current production situation. For the most part, the curtailment of Canadian auto industry production has been to bring high U.S. inventories into line, not because of Canadian sales. To date, the Big Four North American auto makers have avoided massive layoffs of Canadian assembly workers by extending summer and Christmas vacation time and temporarily suspending production for short periods of time. Nevertheless, there have been several thousand indefinite layoffs.

- . At the end of December, the number of indefinite layoffs in the assembly industry in Ontario totalled 6,225 workers -- approximately 14 per cent of the assembly work force. Included in this total are 725 workers at General Motors, 3,000 at Ford and 2,500 at Chrysler.
- . American Motors will lay off 170 workers indefinitely on the first of February 1980.
- . General Motors will lay off an additional 360 workers indefinitely on February 3, 1980.
- . General Motors currently has 4,100 workers on temporary layoff at its various plants. On January 28, 1980, 6,500 workers will be laid off at its Oshawa car assembly plants for one week.
- . Later this month, Ford will close its Oakville car and van assembly plant for three weeks and its St. Thomas car assembly operation for two weeks. These shutdowns will affect 6,500 workers: 3,400 at Oakville and 3,100 at St. Thomas.

The Auto Pact affords some measure of protection to Canadian assembly production workers. Under the terms of the Auto Pact, General Motors, Ford and Chrysler must maintain production-to-sales ratios. Last year, Canadian unit sales were sustained, rising 1.4 per cent. Sales of North American autos accounted for this strength, as sales of cars produced overseas fell 18.2 per cent. A substantial amount of North American cars sold in Canada, however, were imported from the United States. While U.S. inventories of Canadian produced autos were excessive, Canadian production and employment could not be cut in line with sagging U.S. demand since the value of North American imports sold in Canada was rising. Thus, to maintain Canadian production-to-sales ratios, auto companies had to compensate by even greater reductions of production at their U.S. facilities.

- . Of course, such a safeguard would be redundant were it not for the mismatch of auto models produced in Canada.

The Canadian auto parts manufacturers, however, have no such safeguard and hence suffer the full impact of lower North American production activity. Indeed, their position is aggravated by their extreme dependence on U.S. new car production, which currently is slumping badly.

Employment

- . At present, more than 10,000 Ontario auto parts employment are laid off -- approximately 19 per cent of the parts industry's work force.

. Comparison to 1975 Auto Industry Conditions

While both the current and the 1974-1975 cyclical downturns were triggered by energy shocks, the impact on production and employment in the auto industry as of October 1979 had not reached the magnitude of the 1975:1 crisis. However, October 1979 (the most recent period for which data is available), is not likely to be the trough of this current downturn.

- . While production cuts from the peak have been substantial in the current downturn, employment losses have not been as severe, especially in the motor vehicle assembly sector. More layoffs, however, will occur as production continues to be cut.
- . The duration of the current downturn in the motor vehicle assembly sector is already markedly longer than in 1974-1975.

PEAK TO TROUGH COMPARISON

Table 3

	The 1973-75 Downturn			The Current Downturn		
	Severity (%)	Peak	Trough	Severity (%)	Peak	End Point
<u>Motor Vehicles</u>						
. Canadian Production	-33.6	Nov. 74	Jan. 75	-27.2	Oct. 78	Oct. 79
. Canadian Employment	-22.6	Sept. 74	Jan. 75	-3.5	May 79	Oct. 79
. Ontario Employment	-25.3	Dec. 74	Jan. 75	-5.5	Oct. 77	Oct. 79
<u>Parts and Accessories</u>						
. Canadian Production	-37.4	June 73	Feb. 75	-26.6	Jan. 79	Oct. 79
. Canadian Employment	-31.1	Oct. 73	Jan. 75	-17.3	Oct. 78	Oct. 79
. Ontario Employment	-31.6	Oct. 73	Jan. 75	-18.3	Oct. 78	Oct. 79

. U.S. Sales

Poor sales performance in the U.S. has hurt Canadian auto and truck producers since over 70 per cent of our auto production and almost 40 per cent of our truck production is exported south of the border. The U.S. economic slowdown in 1979 accounted for the 8.3 per cent drop in total U.S. motor vehicle

unit sales. The weaknesses were primarily concentrated in North American produced motor vehicles, reflecting the uncertainties about gas availability.

- . In 1979, North American built auto and truck sales in the U.S. plunged by 10.5 and 20.2 per cent respectively. Sales of imported autos and trucks, which are generally more fuel efficient, increased by 16.4 and 39.7 per cent respectively.

UNIT MOTOR VEHICLE SALES IN THE U.S., 1979
(Per Cent Change, From Year-Earlier Period)

Table 4

	1979:1	1979:2	1979:3	1979:4	1979
Autos	7.8	-11.9	-5.2	-11.6	-5.8
. North American	6.3	-18.5	-8.4	-17.9	-10.5
. Imports	14.3	21.0	8.0	23.8	16.4
Trucks	2.5	-21.9	-16.7	-23.0	-15.3
. North American	-1.4	-28.8	-21.2	-27.0	-20.2
. Imports	46.0	71.6	30.5	15.7	39.7
Total	6.4	-14.5	-8.3	-14.6	-8.3

In 1979, imports captured a greater share of the U.S. auto market. The import auto share of the U.S. market rose to 21.8 per cent in 1979 from 17.6 per cent in 1978. Similarly, the import truck share rose to 13.5 per cent from 8.2 per cent.

- . The import manufacturers themselves believe that their auto market share will drop to its traditional 17 per cent level once domestic manufacturers retool to meet the need for smaller cars. This retooling process, however, is several years from completion.

. Mismatch of Production with Sales

Most of the 1979 models produced in Canada were intermediate and standard (large) size, with very few compacts being assembled here, as seen in Table 5.

- . For the most part, 1980 model production remains unchanged. Two notable exceptions, however, are the introduction by Ford of two subcompact lines, Pinto and Bobcat, at their St. Thomas plant, and the downsizing by Chrysler of the Cordoba and the Miranda, formerly the Magnum, at their Windsor plant.

MAKES AND SIZE OF AUTOS PRODUCED IN CANADA

Table 5

Company	Cities	1979		1980	
		Model	Size Class	Model	Size Class
American Motors	Brampton	Concord	Compact	Jeep CJ-5, CJ-7	Recreational Vehicle
Chrysler	Windsor	Cordoba	Intermediate	Cordoba	Intermediate
		Magnum	Intermediate	Mirada	Intermediate
		Newport	Standard		
		Sportsman	Compact Van	Sportsman	Compact Van
Ford	Oakville	Voyager	Compact Van	Voyager	Compact Van
		Ford LTD	Standard	Ford LTD	Standard
	St. Thomas	Club Wagon	Compact Van	Club Wagon	Compact Van
		Fairmont	Compact	Fairmont	Compact
General Motors	Oshawa	Zephyr	Compact	Zephyr	Compact
				Pinto	Subcompact
				Bobcat	Subcompact
		Chevrolet	Standard	Chevrolet	Standard
		Monte Carlo	Intermediate	Monte Carlo	Intermediate
	Scarborough	Malibu	Intermediate	Malibu	Intermediate
		Pontiac	Standard	Pontiac	Standard
		Le Mans	Intermediate	Le Mans	Intermediate
		Sportvan	Compact Van	Sportvan	Compact Van
		Vandura	Compact Van	Vandura	Compact Van
	St. Therese	Rally	Compact Van	Rally	Compact Van
		Cutlas	Intermediate	Cutlas	Intermediate
		Grand Prix	Intermediate	Grand Prix	Intermediate

An examination of the market segmentation in the U.S. shows a strong trend toward smaller cars, as seen in Table 6.

- Sub-compact sales in 1979 were up 45.7 per cent from their 1978 level and now capture 21.2 per cent of the market compared to 13.0 per cent in 1978.
- 1979 sales of intermediates and standard size autos were down 22.4 and 20.0 per cent respectively from their 1978 levels.
- In addition, a large number of vans are produced in Canada for the U.S. market, and sales of these vehicles declined 30.6 per cent.

U.S. AUTO SEGMENTATION, 1978 and 1979
(North American Built Only)

Table 6

Type	Sales			% Share	
	1979	1978	% Change	1979	1978
Subcompact	1,762,050	1,209,320	45.7	21.2	13.0
Compact	1,936,150	2,224,380	-13.0	23.3	23.9
Intermediate	2,334,499	3,007,774	-22.4	28.0	32.3
Standard	1,708,790	2,137,160	-20.0	20.5	23.0
Luxury	483,936	581,547	-16.8	5.8	6.2
Van	102,630	147,817	-30.6	1.2	1.6

- . In 1979, North American manufactured subcompact and compact models captured 44.5 per cent of the U.S. new car sales market. Including sales of imports, the subcompact/compact U.S. market share was over 50 per cent.

BY MODEL PRODUCED IN CANADA

Table 7

	Sales		% Change
	1979	1978	
Cordoba	61,801	105,442	-41.4
Magnum	24,784	48,326	-48.7
Newport	87,451	67,892	28.8
Ford	272,265	471,877	-42.3
Fairmont	338,819	405,780	-16.5
Zephyr	99,335	120,781	-17.8
Pinto	187,708	167,880	11.8
Bobcat	44,674	30,201	47.9
Chevrolet	449,001	621,140	-27.7
Monte Carlo	265,877	355,058	-25.1
Malibu	344,233	374,124	-8.0
Pontiac	171,301	209,536	-18.2
Le Mans	114,993	125,020	-8.0
Cutlas	113,465	113,286	0.2
Grand Prix	175,573	224,195	-21.7
Subtotal	2,751,280	3,440,538	-20.0
N.A. Total	8,328,055	9,307,998	-10.5
Import Total	2,320,745	1,992,914	16.4
U.S. Total	10,648,800	11,300,912	-5.8

- . In 1979, U.S. sales of models produced in Canada declined by 20.0 per cent. The Newport, Pinto and Bobcat were the only models for which significant sales increases were recorded. In fact, the Pinto and Bobcat are the only subcompacts produced in Canada, and production of these models in Canada just began in September 1979. Production in Canada of the Newport ceased in August 1979.

U.S. Auto Inventory Position

As noted earlier, the curtailment of Canadian auto production has been due, for the most part, to high U.S. inventory levels. A significant improvement in Canadian auto production activity will occur only once the high U.S. inventory is run-down. As of December 31, 1979, U.S. inventories of North American produced autos were at their highest levels since 1974. U.S. auto makers had on average 76 days supply -- 65 days supply is considered normal for this time of year.

- . Of the models produced in Canada, only the Cutlass (55 days supply), the Zephyr (63 days supply), the Fairmont (69 days supply) and the Pontiac (72 days supply) had lower than average days supply.
- . As of December 31, 1979, U.S. inventories of overseas produced autos was 60 days supply, lower than normal for this time of year. By country of origin, the level was 48 days for Japanese makes, 81 days for German and 238 days for "others".

. Canadian Sales

Canadian sales figures do not reflect the poor underlying performance of Canadian motor vehicle production and employment, as seen in Table 8. Auto sales surpassed the one million unit level in 1979, a new sales record. General Motors and American Motors led the way with a record sales year.

- . Reflecting the greater security of gas supplies here, unit sales of North American cars in Canada increased by 5.9 per cent in 1979. The cheaper dollar worked against imports, whose sales dropped by 18.2 per cent.

CANADIAN UNIT AUTO SALES, 1978-1979

Table 8

	Sales			% Share	
	1979	1978	% Change	1979	1978
North American	857,183	809,653	5.9	85.2	81.6
- American Motors*	23,362	20,416	14.4	2.3	2.1
- Chrysler	156,800	166,677	-5.9	15.6	16.8
- Ford	204,821	203,580	0.6	20.4	20.5
- General Motors	472,200	418,980	12.7	46.9	42.2
Imports	149,070	182,318	-18.2	14.8	18.4
Total	1,006,253	991,971	1.4	100.0	100.0

* Excludes Jeep sales.

The pattern for truck sales was similar to that for autos. During the first eleven months of 1979, unit truck sales rose 4.3 per cent. Sales of North American manufactured trucks rose 5.1 per cent, while sales of imports fell 16.9 per cent.

- According to preliminary annual data, Canadian unit sales of trucks produced by the Big Four rose by 8.6 per cent in 1979. General Motors led all companies in growth, recording an increase in sales for 1979 of 15.1 per cent.

. Auto Trade

The decline in U.S. auto sales cut into our exports. Canadian auto sales, however, have remained buoyant. Consequently, imports, most of which come from the United States, are higher. In the first eleven months of 1979, motor vehicle exports in dollar terms dropped by 9.4 per cent over the corresponding period in 1978 whereas imports continued to climb, standing 21.3 per cent higher. Auto parts exports growth in the first eleven months of 1979 was quite modest, particularly since U.S. motor vehicle production in 1979 dropped 10.9 per cent.

- The deterioration in the 1979 auto trade began in the second quarter and has continued throughout the remainder of the year.

CANADIAN AUTOMOTIVE TRADE, 1978-1979 November
(Per Cent Change Over Year-Earlier Period, in Value)

Table 9

	1978	1979:1	1979:2	1979:3	1979 Jan-Nov
Exports	22.0	26.8	-6.9	-9.3	-4.7
. Motor Vehicles	17.4	18.4	-16.1	-5.8	-9.4
. Parts and Accessories	29.5	40.8	8.5	-13.3	3.4
Imports	16.5	35.5	12.2	9.0	12.8
. Motor Vehicles	15.1	28.1	21.2	23.3	21.3
. Parts and Accessories	17.4	39.8	6.6	1.1	7.0

As Table 10 shows, in the first eleven months of 1979, the total auto trade deficit reached \$2.9 billion, three and a half times the 1978 annual deficit. The January-November 1979 deficit with the U.S. is almost five times its 1978 annual level. The motor vehicle surplus shrank significantly last year while the parts and accessories deficit widened marginally.

AUTOMOTIVE TRADE DEFICIT, 1978-1979 November
(\$ Millions)

Table 10

	1978	1979:1	1979:2	1979:3	1979 Jan-Nov
Deficit (all countries)	-820	-445	-1,124	-728	-2,900.4
. Motor Vehicles Surplus	2,528	725	14	34	558.6
. Parts and Accessories Deficit	-3,357	-1,174	-1,143	-769	-3,459.0
Deficit (with U.S.)	-562	-336	-1,126	-676	-2,806.1
. Motor Vehicles Surplus	2,711	813	39	44	796.0
. Parts and Accessories Deficit	-3,273	-1,149	-1,165	-720	-3,602.1

OUTLOOK FOR 1980

Canadian motor vehicle production will plummet 11.5 per cent in 1980 as a result of a weak export market and an expected slowdown in Canadian demand, according to the Conference Board. Canadian parts production is expected to remain weak in 1980 as automakers run down their inventories, especially in the U.S. In order to keep inventories of unsold cars from growing to alarmingly high levels by spring, the U.S. auto makers plan to build only 1,866,000 cars in the first quarter of 1980, down 22.7 per cent from a year earlier. This will severely curtail Canadian parts production in the first quarter of 1980 since approximately 75 per cent of their output is exported to the U.S.

Canadian unit auto sales will drop 3.8 per cent in 1980, according to Data Resources. General Motors, who had forecasted a bullish increase in auto and truck sales of 7.1 per cent in 1980, have, in recent weeks, drastically revised their forecast downwards and now expect at best a slight increase in total Canadian motor vehicle sales. Meanwhile, International Harvester predicts 1980 will be like 1979, a banner year for big trucks.

Most economic forecasters are predicting that U.S. auto sales will decline by approximately 1,000,000 units in 1980. The private forecasts of total U.S. car sales range from 8.6 million units by Merrill Lynch to 10.0 million units by New York's Citibank. The auto companies themselves have also revised down their 1980 auto sales forecasts. While Chrysler is forecasting car sales of only 9.25 million, General Motors, the most optimistic of the auto companies, is forecasting car sales of 11 million units and truck sales of 3.1 million units. Ford is forecasting combined car and truck sales of 12.7 million units.

- . U.S. sales of models produced in Canada will be weaker than for the industry as a whole, since the mismatch will continue.
- . Most of the forecasts have U.S. sales bottoming out during the second quarter of 1980.
- . Unit sales of imported cars will also decline in 1980; however, the import share of the U.S. new car market should remain in the 22 per cent range.

AUTO SECTOR OUTLOOK, 1978-1980			Table 11
	1978	1979	1980
<u>CANADA</u>			
Production (% Change)			
. Motor Vehicles	1.0	-8.3	-11.5
. Parts	5.5	-10.0	-9.0
Unit Auto Sales (000's)			
. Cars	993	1,006	968
. Cars and Trucks	1,367	1,400	1,400 - 1,500
<u>UNITED STATES</u>			
Domestic Auto Production	-1.0	-7.8	-9.4
Unit Auto Sales (Millions)	11.3	10.6	8.6-11.0
Source: Conference Board, Data Resources, General Motors, Merrill Lynch and the U.S. Department of Commerce.			

The auto sector trade deficit should continue to worsen in 1980. Our motor vehicle surplus will dwindle further since higher energy prices will increase Canadian purchases of fuel efficient imports and the soft U.S. auto market and high U.S. inventories will weaken exports. The outlook for the parts deficit is gloomier: exports will be adversely by the forecasted 10 per cent drop in U.S. 1980 auto production.

- . Canada's auto trade deficit with all countries could reach \$3.5 billion in 1980, an increase of \$500 million from last year's deficit. The parts sector will account for most of the increase in this years deficit. In fact, DRI has forecast the parts deficit to exceed \$8 billion by 1985.

MEDIUM TERM ISSUES

Investment

. Downsizing of Auto Models

In response to the energy crunch the auto companies are attempting to improve vehicle mileage. To do so they have adopted a strategy of reducing vehicle weight -- downsizing. This strategy has taken two forms: reducing the physical size of the vehicle and switching to lighter materials. Consequently, record levels of investment are planned for the assembly industry. For the parts industry, downsizing means major business opportunities.

The Big Four auto companies expect to invest \$75 billion between 1980 and 1985 in their North American operations. At present, approximately \$4.8 billion of this investment is scheduled for Canada.

- . An additional \$3 billion of investment in Canada is required in order to close the production-to-consumption gap.
- . Closing the production-to-consumption gap would create 27,000 jobs in the auto industry and increase activity in auto related industries -- primary metal, metal fabricating, machinery, plastics, textiles, etc -- which in turn would generate at least another 27,000 jobs.

. Details of the Big Three's 1980 Investment Intentions for Canada

Although exact investment intentions for the auto assembly sector are not available, press reports and independent surveys indicate that the Big Four auto companies will invest \$750 million in 1980 an increase of 50 per cent over last year's level.

- . General Motors will spend \$2 billion over the next three years. Investment projects include a front-wheel drive automatic transmission plant in Windsor, a transmission casting plant and V-6 engine line in St. Catharines, the replacement of the paint finishing system at the car assembly plant in Oshawa, an undisclosed project at the van plant in Scarborough and a program change of the Ste. Therese, P.Q. plant.

- . Ford will spend \$400 million in Canada as work continues on the conversion program at the Windsor engine plant and construction commences in Windsor at both the new Essex engine plant and the Essex aluminum castings plant.
- . Chrysler intends to spend \$1.2 billion over the next ten years in Canada (all of which should occur in Windsor). However little investment activity is scheduled as the company awaits the outcome of the current negotiations for aid with the federal government.
- . The October 1979 Industry, Trade and Commerce large firm survey of investment intentions estimates that capital spending in Canada's transportation equipment sector will be \$1,299.6 million, more than double the level of investment in 1979.
- . The U.S. Department of Commerce estimates that capital expenditures by majority-owned foreign affiliates of U.S. companies will be \$1.56 billion (U.S.) in Canada in 1980, 64.9 per cent higher than their spending in 1979.

. Financial Outlook of the Big Four

The financial position of the Big Four automakers will ultimately determine the feasibility of their investment intentions. The curtailment of motor vehicle production in Canada combined with a similar curtailment in the U.S. has substantially reduced the world-wide earnings of Chrysler, Ford and General Motors. The situation is further aggravated since the autos that are selling are the subcompact and compact models which have low profit margins. With the exception of Ford, the auto companies release only world-aggregate financial information. Ford of Canada posted a third quarter loss of \$33.4 million, reducing their year-to-date profit to \$26.4 million. Ford also announced that no fourth quarter dividend would be declared. On a world-aggregate basis,

- . Ford and General Motors recorded third quarter net earnings of \$103.1 million and \$21.4 million respectively. During the same period, however, both Ford and General Motors experienced overall operating losses of \$468.5 million and \$254.6 million respectively.
- . Ford Motor Co. privately projected losses of \$1 billion on North American operations in both 1979 and 1980.

- . Chrysler's third quarter net loss of \$460.6 million brought the 1979 year-to-date deficit to \$721 million. Chrysler's nine month non-North American earnings were \$39.2 million.
- . American Motors, whose fiscal year ends in the third quarter, announced record sales in fiscal 1979 and a doubling of its 1978 earnings. This week, American Motors announced fiscal 1980 first-quarter net earnings of \$12.8 million.

Chrysler's ability to undertake their North American investment plans improved as a result of the \$3.5 billion aid package from the U.S. Congress. In fact, Chrysler investment in Canada may also hinge on government aid. The federal government, before their defeat last December, had been discussing a \$300 million aid package with Chrysler. Nevertheless, two recent development, may put a snag in Chrysler's 1980-1985 operating plan which shows a pre-tax profit forecast of \$3.656 billion for the five year period.

- . Volkswagen has refused to supply Chrysler with more engines than their 300,000 per year contract. Thus Chrysler will not be able to step up its production of the hot selling Omni and Horizon due to the shortage of engines. Although Chrysler has a similar new engine plant coming on stream, all those engines are slated for assembly in Chrysler's new K-body cars (redesigned Aspens and Volares).
- . Mitsubishi, a Japanese automaker, is stepping up pressure to terminate its long-standing distribution agreement with Chrysler. Should Mitsubishi be successful, Chrysler dealers would lose the valuable drawing card for economy-minded car buyers of Plymouth Champ, Arrow and Sapporo and Dodge Colt.

. The Investment Battle

The investment challenge has been hampered by the continuing battle for automobile investment being waged by a number of U.S. States, including Michigan, Ohio, New York and, in particular, Tennessee. These actions on the part of the U.S. States led the federal government and the Province of Ontario to give Ford over \$70 million in grants to establish an engine plant in Windsor. Ontario's share of this package was \$26.4 million, financed by means of a grant from the Employment Development Fund (EDF).

- . The current outlook for front wheel drive cars, especially General Motors' X-cars, and four-wheel drive vehicles is excellent. The procurement of a facility to produce either of these types of vehicles would ensure Ontario a position from which to share in the auto industry's future growth areas.

. Investment Opportunities in the Auto Parts Industry

Due to the enormous costs of the downsizing program, the auto companies will depend more and more on their suppliers for parts manufacture -- not only more parts but also innovations. Hence, vehicle downsizing is, perhaps, the most vital concern of the auto parts industry today. Gone are the days when the auto companies could simply substitute plastics for metal. The future auto parts, of which there are approximately 15,000 that go into a car, will require a deep commitment to research and development by the supplier.

Canada's auto parts producers often claim they cannot break into new markets. Often the reasons for this are beyond their control, e.g., orders from the head office in the case of a non-Canadian multinational. Other times, however, it is a result of poor marketing, poor product design, or the inability to anticipate new markets -- the latter two problems could result from insufficient research and development. Unavailability of capital for expansion should be no excuse. To date, the EDF has provided \$6.125 million in grants and \$1.5 million in loan guarantees to fourteen Ontario parts firms. It is estimated that the grants and loans will, over the next five years, create 2,613 jobs, increase investment by \$96.1 million and raise direct exports by \$658.8 million.

- . In total, the auto parts firms will be required to spend \$16 for every \$1 provided by the Government of Ontario. In contrast, Ford Motor Company of Canada must spend at a higher proportionate rate -- \$20 for every \$1 provided by the Government.

- . Several auto parts manufacturers are undertaking capital expenditures without seeking government aid. Major projects are: a \$7.5 million secondary aluminum smelter by Alcan Aluminum in Guelph, a \$10.5 million iron castings plant by Castec Foundaries in Windsor, a \$20 million expansion of existing plant facilities by Firestone in London, a \$12 million Van trailer plant by Fruehauf Trailer in Ingersoll and an electromechanical devices plant by Modu-Tronics in the Peel-Halton region.
- . For the most part, Canadian auto parts manufacturers supply output for use in intermediate and standard sized cars. In 1979, U.S. unit sales of intermediate and standard sized cars fell 22.4 and 20.0 per cent respectively. It is important that the auto parts manufacturers exploit the future growth areas in the auto industry.

. Fair Share of North American Investment by Overseas Auto Producers

There is a tremendous amount of pressure on the European and Japanese auto makers to establish assembly production facilities in North America, as the depreciation of North American currencies in recent years has priced many foreign manufactured autos out of the market. Indeed, the U.S. government, concerned over their growing overall trade deficit with Japan, has put pressure on the Japanese automakers to locate assembly production facilities in the U.S.. The U.A.W., concerned over the loss of jobs implicit in import car sales, have also lobbied the Japanese automakers to locate in the U.S.. To date, the U.S. has received more than their fair share of the North American investment by overseas auto producers.

In the spring of 1978, Volkswagen opened their Westmoreland County, Pa. auto assembly plant. Today this plant produces more cars than Chrysler's entire Canadian auto assembly operation. Volkswagen also has a stamping plant in South Charleston W. VA.. Volkswagen is currently studying expansion plans, another assembly plant (to be located in the U.S. west of the Mississippi, possibly Los Angeles) and an engine plant (Windsor is one possible site mentioned).

Mercedes-Benz, another European automaker, is building a \$9 million, 130,000 square-foot truck plant in Hampton, Va..

Honda Motor Co., the third largest Japanese car producer, announced this month that they will build a \$200 million auto assembly plant next to its motorcycle assembly plant in Marysville, Ohio. At full capacity, this plant will produce 120,000 cars a year, almost as much as Chrysler Canada's total auto assembly operation. Although Honda's move will have stampeded Japan's two largest auto makers, Toyota and Nissan (Datsun), into announcing similar manufacturing plans, it will probably accelerate the timing of any decision by Toyota and Nissan to build cars in North America (for us, preferably in Canada).

- . The overseas producers have a preference to purchase existing abandoned facilities. Such a facility exists in Windsor (owned by Chrysler). However, competition will be tough as several U.S. auto facilities stand idle (such as a Ford plant in Los Angeles and a Chrysler plant in Hamtramck).

Alternate Fuels

The auto industry's response to the energy crunch is the fuel efficient motor vehicle. The costs are staggering. Phase one is downsizing the existing models, involving huge sums of money for capital investment. Phase two, the development of new technology -- and most notably the search for alternate fuel sources -- is also expensive.

At present, the greatest advances in the development of alternate energy sources have been made in the field of diesel fuel use. Today, many automakers offer diesel powered autos. In 1979, diesel powered autos captured 2.5 per cent of the total U.S. new car market, double their share in 1978. North American produced diesel autos now capture 51.1 per cent of the U.S. diesel new

car market, up from 45.0 per cent in 1978. General Motors, leaders in diesel engine technology, predicts that by 1985, 20 per cent of their new car sales will be diesel powered.

Although diesel energy may improve vehicle mileage by up to 25 per cent, there are some drawbacks to its use. In their present form, diesel engines cannot meet the EPA nitrogen oxide standards for fuel-efficient engines in model years 1981 and 1982, and technological advances are not imminent. Evidence of a diesel-cancer tie is conflicting. Also, with current refinery technology, it takes more crude oil to produce equal amounts of diesel and gasoline. Thus, on a crude-oil savings basis, the switch to diesel fuel is not 25 per cent, as on price, but more like 6 per cent. In fact, this 6 per cent gain could be completely offset by a significant increase in the demand for diesel fuel. Analysts claim that the cost of having to modify existing equipment, enlarge storage capacity, expand marine and pipeline transportation systems, as well as terminal distribution systems and service stations, would be borne by diesel users in the form of higher prices.

There are several other alternate fuel sources being examined today. Gasahol, a mixture of 90 per cent gasoline and 10 per cent alcohol, is currently on the market, though its sale is heavily subsidized. In fact, some studies indicate that it may take more energy to produce gasahol than is saved by its use. Gasahol is compatible with today's engines.

Auto Pact

Ontario has repeatedly taken the position that Canada should be allocated a "fair share" of North American production. It is not clear, however, whether a) the timing of a re-opening of talks on the Auto Pact is appropriate or b) whether the trade power realities which underly the present allocation of production could be reversed in negotiations (or at what price they might be so).

Formal reopening of talks on the Auto Pact at this juncture should consider the following conditions: The U.S. Congress has not been demonstratably willing to provide trade concessions to Canada. The current U.S. recession, especially in autos, and a coming election year make it unlikely that any significant gains can be made at present. The U.S. Administration as well is likely to be inflexible on auto trade given the vulnerability of the U.S. overall trade position to oil price shocks.

In short, the U.S. has a similar balance of payments crisis as does Canada and furthermore Canada has an overall surplus on trade with the U.S. Moreover, the U.S. has to focus on the Chrysler crisis in the short term.

As alluded to by ex-U.S. Ambassador Enders, concessions on the Auto Pact by the U.S. would probably require a liberalization of our energy export restrictions (a route which may be attractive should Canadian energy prices be moved to world levels). Whether this could be in Ontario's or Canada's interests would depend on the nature of the concessions sought by the U.S. negotiators.

The major problem for Canada (and Ontario) is to ensure that it will participate in the downsizing and technological revolution that is occurring as a result of higher oil prices in North America. In principle, Canada should be competitive in this regard given free trade in the industry. If the reason for the inequitable allocation of U.S. production is U.S. government pressure then it would be incumbent upon the federal government to resist that pressure.

Interplay of the Cyclical and Structural Problems

The Ontario auto industry is currently experiencing a cyclical downturn. To date, employment losses have not kept pace with production cuts. However, this situation is expected to worsen. Meanwhile, the industry is undergoing structural changes. Thus, an upturn does not necessarily mean a return to robust production and employment growth. Today's problem cannot be fully solved by the 1975 approach: temporarily bringing auto purchases forward by means of a retail sales tax cut in order to shorten the downturn. The recovery will not fully address the problem -- the mismatch of production to sales. A change in the Canadian production mix is required, and this calls for enormous amounts of capital spending, in particular, in small car production. The auto makers are planning such investment but their timing is too late. Small car investment must be brought forward. Loans and/or grants to the auto companies could help finance accelerated investment spending.

A source of revenue must first be found to finance such a program. A tax on auto repair service may satisfy the criteria. Such a tax also has fuel conservation side-effects. The tax would increase the relative price of existing cars (since they require more repair), hence people would buy newer more fuel

efficient cars. Indeed, the shift to new cars could be accelerated by a temporary partial reduction in the retail sales tax on new (small) cars. This would still leave plenty of funds available to subsidize small car investment. Although a move to stimulate new car sales would probably have an adverse impact on the auto trade balance, the impact on the deficit is, nevertheless, temporary (since the accelerated investment program would soon have small cars being produced in Ontario) while the fuel savings of a higher mileage auto fleet is permanent. Alternatively, some of this tax revenue could be used to train skilled workers, especially in skills that would be required by the new auto technology.

Chrysler

Chrysler's current problems may provide Canada and Ontario an opportunity to secure a better deal for our manufacturing activity. With Chrysler, or with another company using the money saved by not bailing out Chrysler, Ontario could make grants conditional on such things as Canadian content. Several companies would be interested in buying out Chrysler: Volkswagen, Toyota, Nissan (Datsun). In fact, Volkswagen's and Mitsubishi's reluctance to aid Chrysler may be a conscious effort to promote Chrysler's demise in order that a takeover at the right (cheap) price, would be possible. Although Chrysler's Canadian assembly facilities are inefficient, their Canadian parts operations are highly profitable.

A takeover of Chrysler Canada by an overseas producer would mean that the new company would be outside the Auto Pact, therefore, it would have to pay duty on exports to the U.S. Location in Canada should be beneficial since U.S. auto tariffs are a third of Canada's. Likewise, Chrysler U.S.A. would also

have to pay duty on exports to Canada. However, extension by the federal government of the duty remission scheme to Chrysler would be a boom to our parts manufacturers. Thus, a Chrysler takeover by an overseas producer would benefit Canadian production and employment and hasten small car production in Canada.

Fuel Research and Development

At present, the auto companies bear the full cost for research and development into fuel economy and fuel emission. If the oil companies were forced to assume this responsibility it would lessen the cost on the auto companies, improve their profitability and allow them to accelerate their investment plans. The benefit of such a policy would be to improve the productive capacity of the auto companies (located in Ontario) while imposing additional costs on the oil companies (who are unable to pass these costs back to the consumer since their prices are regulated).

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